

# **Report of the auditor-general to the Northern Cape Provincial Legislature and the council on Ubuntu Local Municipality**

## **Report on the audit of the financial statements**

### **Qualified opinion**

1. I have audited the financial statements of the Ubuntu Local Municipality set out on pages X to X, which comprise the statement of financial position as at 30 June 2017, and the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion section of my report, the financial statements present fairly, in all material respects, the financial position of the Ubuntu Local Municipality as at 30 June 2017, and its financial performance and cash flows for the year then ended in accordance with Standards of Generally Recognised Accounting Practice (standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2016 (Act No. 3 of 2016) (DoRA).

### **Basis for qualified opinion**

#### **Receivables from non-exchange transactions**

3. I was unable to obtain sufficient appropriate audit evidence regarding receivables from speed fines and related provision for impairment for the current and prior year due to the status of the accounting records and non-submission of the supporting documentation. I could not confirm the receivables from non-exchange transactions and the related provision for impairment by alternative means. Consequently, I was unable to determine whether any adjustment relating to receivables from non-exchange transactions stated at R127 696 996 (2016: R101 624 996) and the related provision stated at R122 968 901 (2016: R100 276 594) in note 10 to the financial statements was necessary.

#### **Revenue from non-exchange transactions**

4. I was unable to obtain sufficient appropriate audit evidence for revenue non-exchange transactions - speed fines for current and prior year as the municipality did not have adequate systems to maintain records of speed fines. I could not confirm the revenue from speed fines by alternative means. Consequently, I was unable to determine whether any adjustment to the revenue speed fines stated at R30 497 935 (2016: R11 667 728) in note 28 to the financial statements was necessary.

5. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for revenue from non-exchange transactions property rates and receivables from non-exchange property rates as described in note 43.8 to the financial statements. The restatement was done to rectify a misstatement that occurred in the previous financial year, but the restatement could not be substantiated by supporting audit evidence. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustment to both the prior year revenue and receivables from non-exchange transactions property rates stated at R5 802 067 and R5 767 134 in note 25 and note 10 respectively to the financial statements were necessary.
6. During 2016, the municipality did not account for revenue from non-exchange transactions - speed fines in accordance with IGRAP1, *Applying the probability test on initial recognition of revenue*. This resulted in speed fines, being overstated by R3 707 303 as the municipality recorded some of the fines on a cash basis instead of accrual basis. I was unable to determine the full extent of the misstatement relating to revenue speed fines and receivables – speed fines, as it was impractical to do so.

#### Revenue from exchange transactions

7. The municipality did not perform estimates for metered water and metered electricity as required by GRAP 9, *Revenue from exchange transactions*. I was unable to determine the full extent of the misstatement relating to service charges and receivables from exchange transactions as it was impractical to do so.
8. The municipality did not charge interest on some of the consumer debtors accounts that were outstanding for a period of more than 90 days as required by GRAP 104, *Financial instruments*. I was unable to determine the full extent of the misstatement relating to service charges, receivables from exchange and receivables from non-exchange transactions as it was impractical to do so.
9. During 2016, I was unable to obtain sufficient appropriate audit evidence for service charges – indigents subsidies due to the status of the accounting records and non-submission of supporting documentation. I was unable to confirm both the service charges – indigents and receivables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to service charges and receivables from exchange transaction stated at R17 556 712 and R4 339 139 in note 21 and note 11 respectively to the financial statements was necessary.

#### Payables from exchange transactions

10. I was unable to obtain sufficient appropriate audit evidence for payments received in advance (debtors with credit balances) due to the poor status of the accounting records. I could not confirm the payments received in advance (debtors with credit balances) by alternative means. Consequently, I was unable to determine whether any adjustments to payments received in advance (debtors with credit balances) stated at R3 268 227 (2016: R3 832 172) in note 17 to the financial statements were necessary.

## **General Expenditure**

11. During 2016 I was unable to obtain sufficient appropriate audit evidence for general expenditure due to the poor status of the accounting records. I could not confirm the general expenses by alternative means. Consequently, I was unable to determine whether any adjustments to general expenditure stated at R9 495 469 in note 37 to the financial statements were necessary.

## **Irregular expenditure**

12. The municipality did not include the required information on irregular expenditure in the notes to the financial statements, as required by section 125(2)(d)(i) of the MFMA. The municipality incurred expenditure in contravention of the supply chain management requirements, resulting in irregular expenditure being understated in the current and prior year. I was not able to confirm the amount of irregular expenditure to be disclosed by alternative means. Consequently, I was unable to determine whether any adjustments to irregular expenditure R8 598 425 (2016: R819 041) as disclosed in note 50 to the financial statements, was necessary

## **Unauthorised expenditure**

13. The municipality did not fairly disclose unauthorised expenditure incurred as required by section 125 (2)(d)(i) of the MFMA due to a lack of adequate systems. As a result, I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed as unauthorised expenditure. I could not confirm this by alternative means. Consequently, I was unable to determine whether any further adjustment to unauthorised expenditure, R101 699 554 as disclosed in note 48 to the financial statements, was necessary.
14. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.
15. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' Code of ethics for professional accountants (IESBA code) together with the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
16. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

## **Material uncertainty related to going concern**

17. I draw attention to the matter below. My opinion is not modified in respect of this matter.
18. I draw attention to note 46 in the financial statements, which indicates that the municipality incurred a net deficit of R66 348 465 during the year ended 30 June 2017 and, as at that date the municipality's the current liabilities exceeded the current assets by R58 967 986. As stated in note 46, these events or conditions, along with other matters as set forth in note 46, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern.

## **Emphasis of matters**

19. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Restatement of corresponding figures**

20. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2016 have been restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2017.

### **Material impairments – receivables from exchange transactions**

21. As disclosed in note 11 to the financial statements, a significant allowance for impairment of receivables from exchange transactions was made which constitutes 92.3% (R56 672 069/ R61 011 208) of the total receivables from exchange transactions balance.

### **Material losses - electricity**

22. As disclosed in note 51 to the financial statements, material electricity losses to the amount of R11 816 650 (2016: R1 298 489) was incurred which represents 67% (2016: 20%) of the total electricity purchased.

### **Fruitless and wasteful expenditure**

23. As disclosed in note 49 to the financial statements, fruitless and wasteful expenditure to the amount of R5 349 811 was incurred, as a result of mainly interest on overdue accounts. In addition, R5 481 347 that was incurred in the previous years were still not investigated.

## **Other matters**

24. I draw attention to the matters below. My opinion is not modified in respect of this matter.

### **Unaudited disclosure notes**

25. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

## **Responsibilities of accounting officer**

26. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with SA standards of GRAP and the requirements of the MFMA and DoRA and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
27. In preparing the financial statements, the accounting officer is responsible for assessing the Ubuntu Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless there is an intention either to liquidate the municipality or to cease operations, or there is no realistic alternative but to do so.

## **Auditor-general's responsibilities for the audit of the financial statements**

28. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
29. A further description of my responsibilities for the audit of the financial statements is included in the annexure to the auditor's report.

### **Report on the audit of the annual performance report**

30. I am unable to audit and report on the usefulness and reliability of the performance information as the annual performance report of the municipality was not prepared as required by section 46 of the Municipal Systems Act and section 121(3)(c) of the MFMA.

### **Report on audit of compliance with legislation**

#### **Introduction and scope**

31. In accordance with the PAA and the general notice issued in terms thereof I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
32. The material findings on compliance with specific matters in key legislations are as follows:

#### **Strategic, planning and performance management**

33. The IDP was not developed or adopted by the council after the start of its elected term, as required by section 25(1) of the MSA.

34. The SDBIP for the year under review was not developed or approved by the mayor as required by section 53(1)(c)(ii) of the MFMA.
35. A performance management system was not established as required by section 38(a) of the MSA and municipal planning and performance management regulation 8.

#### Annual financial statements, performance and annual reports

36. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of commitments, receivables, operating expenditure and revenue identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
37. The annual financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126(1)(a) the MFMA.
38. The annual performance report of Ubuntu Local Municipality was not prepared, as required by section 46 of the MSA.
39. The 2015/16 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.

#### Procurement and contract management

40. I could not obtain sufficient appropriate audit evidence that all contracts were awarded in accordance with the legislative requirements as the auditee did not provide us with the necessary information within the required time.
41. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c). Similar non-compliance was also reported in the prior year.
42. Some quotations were accepted from prospective providers who were not on the list of accredited prospective providers, in contravention of SCM regulations 16(b) and 17(b). Similar non-compliance was also reported in the prior year.
43. Some quotations were accepted from bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
44. Some quotations were accepted from bidders whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43. Similar non-compliance was also reported in the prior year.
45. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and Treasury Regulations 16A6.3(b).

46. The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the upgrading of roads in Victoria West.
47. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA. Similar non-compliance was also reported in the prior year.

#### Consequence management

48. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
49. Irregular expenditure and fruitless and wasteful expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

#### Expenditure management

50. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
51. Effective steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the irregular expenditure could not be quantified as indicated in the basis for qualification paragraph. The majority of the disclosed irregular expenditure was caused by not following supply chain management requirements.
52. Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R5 349 811, as disclosed in note 49 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by the municipality not being able to pay their creditors within 30 days thereby incurring interest on outstanding debts.

#### Asset management

53. The municipality did not establish an investment policy that was adopted by council, as required by section 13(2) of the MFMA.
54. Capital assets were disposed without the approval of the council, as required by section 14(2)(a) of the MFMA.

#### Utilisation of conditional grants

55. The municipality did not evaluate its performance in respect of programmes funded by the Municipal Infrastructure Grant and Financial Management Grant, as required by section 12(5) of the Division of Revenue Act.

## Revenue Management

56. A tariff policy was not adopted for the levying of fees for provision of municipal services, as required by section 74(1) of the Municipal Systems Act and section 62(1)(f)(i) of the MFMA.
57. A credit control and debt collection policy was not adopted, as required by section 96(b) of the Municipal Systems Act and section 62(1)(f)(iii) of the MFMA.
58. A policy on the levying of rates on rateable property within the municipality was not adopted, as required by section 3(1) of the Property Rates Act and section 62(1)(f)(ii) of the MFMA.
59. An adequate management, accounting and information system which accounts for receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.
60. An effective system of internal control for revenue was not in place, as required by section 97(e) of the MFMA.

## Budget management

61. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the unauthorised expenditure could not be quantified as indicated in the basis for qualification paragraph. The majority of the disclosed unauthorised expenditure was caused by lack of processes to avoid incurring expenditure in excess of the budget.

## Other information

62. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report thereon and those selected development priorities presented in the annual performance report that have been specifically reported on in the auditor's report.
63. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
64. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
65. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate, however, if it is corrected this will not be necessary.

## **Internal control deficiencies**

66. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
67. The leadership did not oversee financial and performance reporting, compliance and related internal controls. The leadership did not ensure processes were in place for reviews to be performed prior to the submission of information, as material errors were detected in the financial statements and non-compliance with legislation and internal control deficiencies were noted throughout the audit process.
68. Senior and top management did not adhere to internal controls, which resulted in unauthorised and irregular expenditure not being detected and non-compliance with relevant legislation.
69. There was a lack of consequences for non-compliance with the relevant legislation as no steps were taken to identify persons liable for unauthorised, irregular and fruitless and wasteful expenditure.
70. The municipality did not have a proper record management system or an approved record classification system to maintain information. This included information that related to the collection, collation, verification, storing and reporting of actual performance information, which resulted in the municipality not being able to provide the Annual Performance Report for audit purposes.
71. The municipality did not review and monitor compliance with applicable legislation. The municipality did not have a delegated employee that was trained to address and monitor new legislative changes affecting the municipality. The majority of compliance paragraphs related to non-adherence with the procurement processes. The municipality did not ensure that all procurement requirements were met prior to approving quotations and contracts.
72. The municipality did not develop adequate controls and monitoring activities to respond to risks identified during the risk management process.

73. The municipality only had an internal audit unit for one quarter of the year, this was due to the municipality not paying the internal auditors, this has resulted in the internal audit unit not being able to discharge its responsibilities.
74. The municipality did not have an audit committee in place for the financial year under review.

Kimberley

Auditor General

27 March 2018



*Auditing to build public confidence*

## **Annexure – Auditor-general’s responsibility for the audit**

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected [objectives/development priorities] and on the municipality's compliance with respect to the selected subject matters.

### **Financial statements**

2. In addition to my responsibility for the audit of the financial statements as described in the auditor's report, I also:

identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control.

evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.

conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Ubunu Local Municipality's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor's report. However, future events or conditions may cause a municipality to cease to continue as a going concern.

evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

### **Communication with those charged with governance**

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other

matters that may reasonably be thought to have a bearing on my independence and here applicable, related safeguards.